



STATE OF CALIFORNIA  
**FRANCHISE TAX BOARD**  
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March 5, 2001

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Information Letter  
20-0762

Dear \*\*\*\*\*:

Your letter of \*\*\*\*\* , has been assigned to me for response. My review of your letter indicates that you are, in effect, requesting a Chief Counsel Ruling. While it is the policy of the Franchise Tax Board to respond to inquiries from taxpayers, the Franchise Tax Board will ordinarily not issue a ruling, or may decline to issue a ruling, because of the factual or fact intensive nature of the inquiry, among other reasons. For your convenience, attached you will find a copy of Franchise Tax Board Notice 89-277, which identifies and discusses the guidelines for ruling requests. I would call your attention to page 6, Non-Corporate Taxpayers, section D. Instructions to Taxpayers Requesting Advance Rulings.

We appreciate the fact that you are concerned with correctly reporting the income from the generation-skipping trust you manage. Unfortunately, we cannot issue a ruling on your request because the analysis is very fact intensive and specific; minor changes in the facts can lead to a different result.

Nevertheless, we are pleased to provide you with a discussion of the issues that arise regarding California's taxation of trusts in general, and to provide you with some guidance as to what factors will be important in determining whether, and to what extent, California may subject your trust to tax in the future. You should be aware, however, that this letter is being provided to you for informational purposes only and may not be considered "written advice from the Board" within the meaning of Revenue and Taxation Code section 21012. You should also be aware that this discussion is subject to change in the event of a change in relevant statutory authority, judicial or administrative case law, or a change in federal interpretation of federal law where the discussion is based upon such interpretation.

In your letter dated \*\*\*\*\* , you provided the following facts:

- \*\*\*\*\*  
\*\*\*\*\*.
- \*\*\*\*\*.
- \*\*\*\*\*.
- \*\*\*\*\*.
- \*\*\*\*\*.

You propose to move the trust to the State of Nevada and to have the principal business of the trust managed by a stockbroker's office located in the City of State Line, Nevada. The purpose for moving the trust to Nevada would be to reduce the potential for the imposition of California income taxes on the trust itself and its beneficiaries in the future.

For the purposes of the following discussion, I have assumed a few facts I believe can be inferred from your letter. First, I have assumed that the trust has at least \*\*\*\*\* and \*\*\*\*\* . Second, I have assumed that the trust can either distribute or retain trust income in any taxable year and that the ability to distribute income to \*\*\*\*\* is limited by an ascertainable standard, such as for \*\*\* health, education, support and maintenance. Third, I have assumed that \*\*\*\*\* are contingent beneficiaries, meaning that \*\*\*\*\* are not entitled to any distributions from the trust of either income or principal unless they survive \*\*\*\*\* and there is undistributed principal or income remaining in the trust. To the extent the assumptions may effect the taxation of the trust, I will attempt to identify the alternative results that are possible if no assumptions were made.

A trust is a taxable entity separate and apart from its beneficiaries<sup>1</sup>. However, the tax imposed on a trust is designed to ensure that one individual income tax is imposed on a trust's income, rather than to impose a separate tax on trust income in addition to the tax imposed on the trust's beneficiaries. For example, many corporations are subject to a separate income tax, in addition to the individual income tax paid by its shareholders on corporate distributions<sup>2</sup>. In the case of trust income, either the trust or its beneficiary will pay the tax on the trust's income, but normally not both<sup>3</sup>. In order for California to tax the income of a trust, one or more of three separate elements must be present: (1) the trust must have income from California sources<sup>4</sup>; (2) a trustee of the trust must be a resident of California<sup>5</sup>; or (3) a non-contingent beneficiary of the trust must be a resident of California<sup>6</sup>.

The general rule in California is that even non-resident taxpayers, including trusts, will be subject to the California income tax to the extent the non-resident taxpayers have gross income from California sources<sup>7</sup>. There are generally five types of income specifically identified as coming from California sources: (1) income from real or tangible personal property located in California; (2) income from a business, trade, or profession carried on within California; (3) compensation for personal services performed in California; (4) income from stocks, bonds, notes, bank deposits, and other intangible personal property, having a business or taxable situs in California; and (5) rentals or royalties for the use of, or for the privilege of using patents, copyrights, trademarks, and similar intangible property in California<sup>8</sup>. The specific rules governing each type of California source income are too

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<sup>1</sup> Internal Revenue Code section 641; Revenue & Taxation Code section 17731 (conformity with Federal law).

<sup>2</sup> Internal Revenue Code section 11; Revenue & Taxation Code section 23151.

<sup>3</sup> Internal Revenue Code sections 651, 652, 661, and 662.

<sup>4</sup> Revenue & Taxation Code section 17951 (California source income).

<sup>5</sup> Revenue & Taxation Code sections 17742 and 17743 (apportionment to resident trustees).

<sup>6</sup> Revenue & Taxation Code sections 17742 and 17744 (apportionment to resident beneficiaries).

<sup>7</sup> Revenue & Taxation Code section 17951.

<sup>8</sup> Cal. Code Regs., tit. 18, § 17951-2 (California source income).

complex to discuss here; however, if your trust were to have any of these types of income, your trust may be subject to California income tax on that income, regardless of where the trust is managed or where the trustees or beneficiaries have their residence.

Turning now to your trust question. Even assuming that your trust did not have any California source income as discussed above, all or a part of your trust's income could still be subject to California's income tax. If all of the trustees of your trust are California residents<sup>9</sup>, like \*\*\*\*\*, then all of the trust's income is taxable by California, regardless of whether the trust has income from California sources or beneficiaries who are residents of California<sup>10</sup>. If only some of the trustees are California residents, like \*\*\*\*\*, and other trustees are not California residents, the trust's income is apportioned to California based upon the percentage of total trustees that are California residents<sup>11</sup>. For example, if your trust has three trustees and only one trustee is a resident of California (i.e. \*\*\*\*\*), one third of your trust's non-California source income will be apportioned to California and two thirds will not be apportioned to California. In addition, if your trust uses a corporate trustee, such as a bank, the residence of that corporate trustee will be the place where the corporation transacts the major portion of its administration of your trust<sup>12</sup>.

Finally, your trust could still be subject to a California income tax, regardless of the residence of the trustees or the source of its income, if your trust has non-contingent beneficiaries who are residents of California. A non-contingent beneficiary is one whose interest is not subject to a condition precedent<sup>13</sup>, and a condition precedent is merely a condition that must be satisfied before the beneficiary will have a right to receive property from the trust. For example, if A will receive the corpus of a trust if, and only if, A survives B, then A's survival is a condition precedent to A's interest in the trust corpus.

In order to determine what trust income will be taxed by California based upon the residence of the non-contingent beneficiaries, two rules must be applied. First, California will tax all of your trust's income if all of the non-contingent beneficiaries of the trust are California residents<sup>14</sup>. Second, if some of your trust's non-contingent beneficiaries are California residents and some are not California residents, then California will apportion any remaining income from your trust, which has not yet been apportioned to California under the rules applicable to California source income or trustees' residences, by the percentage of total non-contingent beneficiaries who are California residents<sup>15</sup>.

Assuming that your trust has the following attributes, your trust will be subject to the tax consequences discussed below: (1) \*\*\*\*\* who is a California resident, and a

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<sup>9</sup> Cal. Code Regs., tit. 18, § 17014 (residents and non-residents).

<sup>10</sup> Revenue & Taxation Code sections 17742, subdivision (a) (taxability of trusts), and 17743 (apportionment to trustees).

<sup>11</sup> Revenue & Taxation Code section 17743.

<sup>12</sup> Revenue & Taxation Code section 17742, subdivision (b) (residence of corporate trustees).

<sup>13</sup> Cal. Code Regs., tit. 18, § 17742(b) (contingent beneficiaries).

<sup>14</sup> Revenue & Taxation Code section 17742, subdivision (a).

<sup>15</sup> Revenue & Taxation Code section 17744.

corporate trustee that transacts the major portion of its administration of your trust in Nevada, making the corporate trustee a Nevada resident; (2) \*\*\*\*\* who will receive all of the trust income for life, and all or a part of the principal of the trust as necessary for \*\*\* health, education, support, or maintenance, and \*\*\*\*\* of which are California residents, and all of which must survive \*\*\*\*\* in order to receive the remaining funds from the trust; (3) \$1000 of California source income; and (4) \$1000 of income from sources outside California. First, all of the \$1000 of California source income will be taxable by California under the source rules above. Second, the \$1000 of income from sources outside of California will be apportioned based upon the residence of the trustees, making 50 percent or \$500 taxable by California because \*\*\*\*\* is a trustee and a California resident. Third, the remaining \$500 will be apportioned to California based upon the residence of the non-contingent beneficiaries of the trust because \*\*\*\*\* is the only non-contingent beneficiary of the trust and is a resident of California. However, if \*\*\*\*\* are not contingent beneficiaries, the third step would make only three quarters of the remaining \$500 taxable by California, because three out of the four non-contingent beneficiaries, \*\*\*\*\*, would be California residents. \*\*\*\*\* would be non-contingent beneficiaries if, for example, \*\*\*\*\* could not use-up all of the trust's assets during \*\*\*\*\* share of the trust was payable to that \*\*\*\*\* estate, regardless of whether any of \*\*\*\*\* survived your wife or each other.

Turning now to the tax return filing requirements for California. Every trustee of a trust that has income for the taxable year that is subject to tax in California under any of the rules discussed above must make a California income tax return for such trust if: (a) the trust's net income exceeds \$100; or (2) the trust's gross income exceeds \$8,000, regardless of the amount of the trust's net income<sup>16</sup>. The return must be made under penalties of perjury, specifically state the items of gross income of the trust, and specify the deductions and credits allowed<sup>17</sup>. In addition, the trustees must provide each beneficiary of the trust with a statement containing the information required to be shown on the return on or before the date the trust's return was required to be filed<sup>18</sup>. Thereafter, a beneficiary of the trust is required to treat items of income included in the beneficiary's gross income in a manner consistent with the treatment of the income in the trust's return<sup>19</sup>.

Based upon the limited facts that you have provided, it would appear that your trust would be subject to a California income tax, regardless of whether you move the management of the trust to Nevada. The only benefit you may realize from moving the management of your trust to Nevada is that one of the trustees of the trust may be considered a non-resident of California, i.e., the percentage of trustees who are California residents compared to the total number of trustees would be reduced and a little less trust income would be allocated to California at this stage.

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<sup>16</sup> Revenue & Taxation Code section 18505, subdivision (a)(5) and (6) (return requirement for trusts).

<sup>17</sup> Revenue & Taxation Code section 18505, subdivision (a) (return requirements).

<sup>18</sup> Revenue & Taxation Code section 18505, subdivision (b) (statement to beneficiaries).

<sup>19</sup> Revenue & Taxation Code section 18505, subdivision (c) (consistent treatment required).

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Because this letter is only intended to provide you with an overall understanding of the taxation of trusts in California, you may wish to consult a tax professional for a more precise application of the law to your particular facts.

Very truly yours

Bradley M. Heller,  
Tax Counsel

Enclosure